



# Assessment of the revenue-generating capacity of Iraq's local governments

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## Introduction

The Scope of Work specifies as the fifth deliverable an

“Assessment of the revenue-generating capacity of local governments (general services and municipal services) to determine their capacity-building needs”,

logically resulting from Task F specified as

“Assess the revenue-generating capacity of local governments (general services and municipal services) to determine their capacity-building needs. The assessment will focus on the user fees and to less extent taxes sources of revenue generation.”

### 1. Determinants of revenue generating capacity

“Capacity” is determined

- 1) mostly, but not exclusively, by the human resources available, their numbers and their skills (human capital); but also
- 2) by equipment and logistic facilities in place (computers, adequate offices with electric power, transport facilities; in short physical capital); and
- 3) by “organizational capital”, which is reflected in organization structure, systems, approach to performance management, practices, routines, manuals, and organization culture.

#### 1.1 Skill sets required for generating governorate revenues

Defining the skill sets required will be a valuable input into the training manual that will be Deliverable 7. Defining the skills needed for revenue generation will also help in drafting the job descriptions of the officers to be employed in governorate revenue departments.

Revenue generation by governorates will require the following functions to be carried out.

- 1) Policy making related to sub-national revenues. Policy making skills include first of all an understanding of the objectives of revenue policies and the economic aspects of taxation and of fees: the impact of taxation on the business environment; the efficiency of a tax in terms of compliance costs and administrative costs; the distinction between tax evasion and tax avoidance; the impact of taxation on the distribution of income and wealth; impact of taxation on incentives. Also an understanding of the extent to which fee rates are cost covering, and of systems of inter-governmental transfers in general and those of Iraq in particular. Furthermore, other skills that are not specific to revenue, like the communication skills needed for dialogue with all stakeholders. Specifically to be mentioned are the analytical skills needed for policy evaluation (revenue analysis).
- 2) Drafting revenue legislation, namely governorate revenue laws and other legal documents (resolutions, instructions).

Internationally, the most prominent source in the area of skills in tax legislation is V. Thuronyi (Ed.): *Tax Law Design and Drafting*, IMF, 1996<sup>1</sup>, with chapters (all in volume I) on the tax legislative process, the legal framework for taxation, the drafting of tax legislation, and one chapter specifically on taxes on land and buildings (Vol. I Chapter 9) which may become very relevant to Iraq’s governorates. There is however not such a similar international work of reference on fees and user charges.

There is no country where all the local governments (provinces and municipalities) have all the legal drafting skills in house that would be ideal. A good way to deal with that is to establish professional associations of provinces and/or municipalities that have that expertise. As an example, the Dutch Association of Municipalities prepares and publishes template documents for many categories of local government revenue, both taxes and fees. Local governments are free to adopt them as they are (and many do), or to amend

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<sup>1</sup> [www.imf.org/external/pubs/nft/1998/tlaw/eng/index.htm](http://www.imf.org/external/pubs/nft/1998/tlaw/eng/index.htm); two volumes, 1172 pages in total.

them (if they think their circumstances are special, and if they are confident enough of their own legal drafting skills).

Legal drafting skills cover such aspects like

- the structuring of the law in chapters and titles;
- the style of numbering articles and clauses;
- adding brief titles for each article;
- inserting an article with adequate definitions of terms used in the law;
- the use of precise, explicit references to other legislation;
- the presence of clear repeals of outdated legislation.

Whilst the above points apply to any law, a revenue law should in particular offer definitions of the basic parameters of taxation, like

- the taxable event,
- the tax base,
- the tax rate,
- the tax payer,
- the frequency of the tax (e.g. annual),
- the frequency of payment (e.g. quarterly or monthly),
- the payment deadline, and
- possible enforcement measures.

If these parameters are not specified, the law will have loopholes that make it vulnerable to great revenue losses. See in particular § 3.2.1 of Deliverable 1 (Legal and Policy Review).

- 3) Revenue administration, the function with the largest staff requirements. It comprises in turn the functions of
  - registration of chargeable persons (e.g. hotels, to pay the tax on the tourism services of hotels) or objects (e.g. properties, to pay real property tax);
  - communication with the citizens;
  - case management;
  - dispute management;
  - debt management and enforcement.

All of these require specific skill sets, including IT skills, communication skills, accounting skills, legal skills, management skills, and more.

- 4) Revenue accounting. Classification and reconciliation skills are needed to compare the payment obligations with the payments actually made by them. Actual payments may combine various payment obligations (including penalties and statutory interest), or may cover them only partially, or may cover obligations that arose only in previous fiscal years, or that will arise only in future fiscal years.
- 5) Revenue reporting. Revenue collecting entities like districts (*qaḍā's*, *nāḥiyahs*) or governorate departments collecting revenues should explain the trends and unexpected deviations in their actual collections by providing a narrative to the revenue department in the governorate capital.
- 6) Revenue forecasting. This plays a crucial role in the annual budget cycle, the credibility of the whole process depends on it. It requires mathematical and econometric skills.

## **1.2 Equipment and logistic facilities**

- All of the six mentioned functions will benefit from computerization. Some of these functions (not all) will also benefit greatly from access to internet and email.
- Computers will work only if electric power is available (this may require power

generators) and if they are supported by Uninterruptible Power Supplies<sup>2</sup> (UPSs).

- For transport, motorcycles are more cost effective than vehicles.
- With respect to communications, revenue officers doing field work (in particular, those working in the enforcement function) will need mobile telephone credit.

### 1.3 Organizational capital

Organizational capital is often accumulated gradually, in the course of time, by piece-meal improvement of examples from the past. One of its pleasant aspects is that governorates can share it freely with each other, by mutually exchanging their experiences.

- Many of the functions listed will benefit from routines like annual work plans fitting within strategic plans, annual reports and eventually more frequent progress reports, annual performance evaluations of staff, Standard Operating Procedures (SOPs) laid down in operational manuals, induction training of new staff, etc.
- Revenue administration will require brochures, to communicate with the citizens, as well as forms. Both the brochures and the forms should be made available via the governorate website, with the revenue laws of the governorate posted as well.
- Revenue accounting will require a good classification of revenues by the Charts of Accounts (CoA) used by the governorates.
- Non-recurrent revenue should be separated from recurrent revenue; taxes should be distinguished from fees; there should be no overlaps and no gaps between the categories; there should be categories for miscellaneous taxes, miscellaneous fees, and miscellaneous revenue; etc. At the federal level there is a detailed CoA, but at the governorate level a CoA does not yet exist. So ideally such a chart should be developed (if the Government of Iraq would support that).

The accounting system used by the Government of Iraq is cash accounting, which is not helpful for the monitoring of arrears incurred by citizens.

**Summary.** Revenue generating capacity has many dimensions, which any capacity building strategy needs to take into account.

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<sup>2</sup> [https://en.wikipedia.org/wiki/Uninterruptible\\_power\\_supply](https://en.wikipedia.org/wiki/Uninterruptible_power_supply)

## 2. Assessment of actual capacity

Assessing actual capacity is presently hampered by several factors.

First, all governorates of Iraq are basically new to revenue generation, having relied in the past solely on transfers coming from the federal government. The Ministry of Finance will retain its presence in the provinces, but its offices will be split, and the governorates will inherit not only part of the revenue sources, but also part of the officers and their skills, part of the equipment and logistic facilities, and part of the organizational capital. Second, the assessment cannot be based on some stable existing revenue assignment, but must be based on assumptions about the assignment of revenue sources in the near future (see Deliverable 4). For instance, if it is decided that in the short term (which we are not recommending) real property tax will have to be administered by governorates, the governorates would need valuation skills, to determine the value of real properties. So, the uncertainty about revenue assignment does not make things easy. Third, the restrictions on travel in Iraq are an obstacle to do field research. Therefore the assessment must remain limited to the following observations.

With respect to functions 1 and 2 and to some of the governorates, the existing capacity is reflected in governorate laws on revenue and their other legal documents on revenue. These demonstrate that the governorates have a tradition of drafting laws, with technical aspects like definitions of special terms, repealing specifically named older laws. However there are specific requirements for drafting revenue laws, like explicit specifications of who should pay, who should not (exemptions), how much should be paid (definitions of tax base and the rate schedule), when it should be paid, and the specification of enforcement provisions. These are very often absent.

Furthermore, the laws generally reflect neglect of elementary principles of revenue policy: the taxes imposed are often ineffective (generating negligible amounts of revenue), inefficient (requiring excessive costs to collect them and comply with them), and unfair by either being non-neutral (discriminating against certain sectors), or burdensome to low-income groups or persons in a vulnerable position.

The existing capacity is also reflected, partly, in the governorate websites. These should be used for professional communication with the citizens. Presently they generally fail to present any legislation, financial reports, or activity reports, instead present dead links and irrelevant information, and fall of short of standards in other ways.

**Recommendation.** Governorates should in due time, when the issue of revenue assignment has been resolved, develop a plan to improve their revenue generating capacity, with attention for their human resources, physical capital, and organizational capital. See Deliverable 6.

With respect to municipalities, the observations to be made are even less, because their revenue generation activities are “in hibernation”, and have ever been so since 2003.